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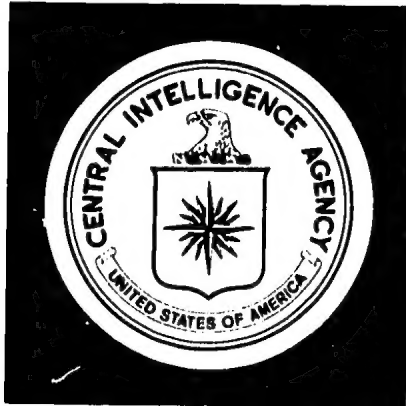
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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

South Africa: Prospects for Gold Sales

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SOUTH AFRICA: PROSPECTS FOR GOLD SALESSummary

1. Even though the gap between South Africa's imports and exports has been widening, the spectacular rise in the free market price of gold has enabled Pretoria to cover the balance readily. Indeed, South Africa probably will be able to handle the 1973 financing requirements -- forecast at US \$1.7 billion, compared with \$1.1 billion in 1972 -- by selling about 600 metric tons of gold in 1973, down substantially from the 715 tons of 1972.

2. South Africa's favorable position is not likely to deteriorate in the second half of 1973. Because Pretoria's sales of gold in the first half have already amounted to about two-thirds of the anticipated balance-of-payments deficit, it has the luxury of withdrawing from the market if the price weakens. Two key international economic conditions also imply a continuing high price for gold during the remainder of 1973: (a) the persistent uncertainties surrounding the valuation of the dollar, the mark, the yen, and other key currencies and (b) the unchecked tide of inflation, which has enveloped not only the domestic economies of developed and less developed countries but also the major international commodity markets. As a partial offset to these bullish considerations, the world's second largest gold producer, the USSR, may market about 300 tons of gold in 1973, compared with 150 tons in 1972, to help pay for its sizable imports of grain.

3. In the short run, the higher price for gold has caused South African mining enterprises to turn to lower grade ores and to reserve the richer ores, thereby extending the profitable life

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of individual mines. With ore-processing capacity fixed in the short run, the lower grade ores yield a smaller physical quantity of gold. In the long run, the higher price of gold will result in the stretching out of the decline in output anticipated in the South African gold industry. In addition to the extension of the life of existing mines, their capacity is being rejuvenated through increased investment. So far, the high price of gold has not continued long enough to induce investment in new mines, which in most cases would have to be sunk to deep levels.

DiscussionThe Role of Gold in the South African Economy

4. South Africa normally produces 60% of the world's newly mined gold. The gold industry is the key factor in the South African economy, since earnings from gold sales serve to cover the substantial annual gap between imports and earnings from non-gold exports and net capital inflows. Financing requirements for the balance of payments have exceeded \$1 billion annually since 1968 (see Table 1).

Table 1

South Africa: Balance-of-Payments Financing
Requirements and Gold Sales and Production

	Financing	Gold Sales		Gold Production
	Million US \$	Million US \$	Metric Tons	Metric Tons
1968	334	422	370	967
1969	1,295	1,333	1,075	970
1970	1,595	1,643	1,398	1,000
1971	1,649	1,569	1,203	976
1972	1,074	1,396	715	910
1973 (first half) ¹	755	1,100	390	425

1. Estimated on the basis of data for January-May 1972.

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5. In 1968-71, financing needs were approximately offset by gold sales, as Pretoria made only small changes in hard currency reserves. In contrast, when financing needs declined in 1972 because of reduced imports and greatly increased exports of non-gold minerals and agricultural products, hard currency reserves rose by about \$320 million. Furthermore, record high prices for gold enabled South Africa to realize these results through marketing a much smaller physical quantity of gold. Whereas the physical volume of gold production dropped 7% in 1972, its dollar value rose 26%.

Changes in the Gold Market

6. South Africa has weathered a series of changes in international gold markets since early 1968. In March 1968 a two-tier gold marketing system was formed to stem speculative runs against official gold holdings. Low trade deficits in 1968 and early 1969 enabled Pretoria to meet its financing needs by selling only a fraction of its gold output. These sales were made both to central banks and, for the first time, to the free market at prices up to \$44 per troy ounce.* The trade deficit worsened thereafter, forcing an increase in Pretoria's sales and a consequent drop in free market prices to \$35 per ounce. Between December 1969 and August 1971, Pretoria made about 35% of its sales to the International Monetary Fund under the terms of a new agreement with international monetary authorities. Almost all of the remainder went to the free market at prices in the range of \$35-\$42 per ounce.

7. Since August 1971, high gold prices and a reduced trade deficit have enabled Pretoria to finance all its needs by sales in the free market. Speculative waves in world money markets caused by international uncertainty over currency values and continued increases in the industrial use of gold have spurred the demand for gold. On the supply side, the amount marketed by South Africa dropped to about 80% of production in 1972, when the trade

* For major changes in official and free market prices of gold since 1968, see Table A-1 in the Appendix.

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gap narrowed. These supply and demand factors combined to drive up the free market price of gold to \$60-\$70 per ounce in the last half of 1972. After February 1973, when South Africa increased marketings to nearly 100% of current output, speculative fever was so high that gold prices soared to an unprecedented \$127 per ounce.

Internal Factors Affecting Gold SalesBalance of Trade

8. South African gold sales have fluctuated in response to domestic requirements for foreign exchange, which in turn have been influenced by cyclical patterns in the volume of imports and exports.* Domestic monetary and fiscal measures taken successively to limit inflation and to stimulate growth have alternately contracted and expanded the volume of investment and consumer spending. As a result, imports of industrial equipment, raw materials, and consumer goods have changed markedly at three-year intervals since 1960. Exports, on the other hand, have grown in response to changes in international demand for South Africa's raw materials and in domestic productivity. For instance, exports of diamonds expand and contract in concert with business in leading luxury markets; and wide variations in rainfall cause sharp year-to-year fluctuations in agricultural exports, which in good years account for one-third of exports. The uneven advance of imports and exports is illustrated by Table 2.

Gold Production

9. South African gold production has begun a slow downward trend after peaking at about 1,000 tons in 1970 (see Table A-3 in the Appendix). Production in 1972 totaled 910 tons, or about 60% of world output. The long-term leveling off and gradual decline in South Africa's output is the result of the vigorous exploitation of an exhaustible natural resource. In the short run (in

* For the annual volume of exports and imports and for other indicators of South Africa's economic activity in 1965-72, see Table A-2 in the Appendix.

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Table 2

**South Africa: Average Annual Growth
of Imports and Exports**

	Percent	
	Imports	Exports
1960-62	1.7	2.8
1963-65	20.0	4.0
1966-68	1.5	11.9
1969-71	15.3	0.5
1972	-2.5	42.9

1972-73), however, the decline in production, contrary to what one might normally expect, is due in large measure to the increases in gold prices. Higher prices induce gold mining enterprises to turn to lower grade ores and to reserve the richer ores, thereby extending the profitable life of individual mines. With ore-processing capacity fixed in the short run, the lower grade ores yield a smaller physical quantity of gold.

Gold and Foreign Exchange Reserves

10. Until recently, Pretoria maintained at least one-half of its reserves in gold bullion. Gold's share of reserves increased to nearly 80% when gold was withheld from the market, following the creation of the two-tier marketing system in 1968, but it returned to 50% in 1971 after gold stocks were used to finance the balance-of-payments deficits of 1969-71. In recent months, both gold and hard currency holdings have grown rapidly as Pretoria reaped record high prices for its gold. As of 1 July 1973, reserves had reached an all-time high of \$2 billion, of which gold constituted 40%.

Expected Upturn in Domestic Activity and Imports

11. Concerned because real economic growth averaged less than 4% annually in 1971-72, Pretoria has launched new stimulative measures that will lead to increased imports throughout 1973. Since December 1972 the government has reduced sales taxes on durable consumer goods, relaxed installment

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credit terms, and made early repayments of \$61 million in compulsory loans that had been exacted from individuals and corporations in the late 1960s as an anti-inflationary measure. The elimination of longstanding bank credit ceilings, the lowering of interest rates, and an increase in the money supply are designed to prod investment. The government's new budget, which covers fiscal year 1974 (April-March), calls for an \$800 million increase in expenditures on defense, debt servicing, civil servant salaries, and other items.

12. The mining boom and widespread wage increases are part of the expansionary picture. Mining profits have jumped as the result of strong foreign demand for South Africa's gold, platinum, diamonds, and copper. Gold and coal mine wages have been raised by 25%, and investment in the platinum, copper, and steel industries is slated for substantial increases. Salary increases of 15% to 17% also have been granted to 500,000 government railroad workers and civil servants, who represent almost 20% of non-agricultural employment. Their raises will total \$300 million per year.

13. Higher investment in inventories almost certainly will be a major stimulant to imports in 1973. Preliminary statistics show that industrial and commercial enterprises already have begun to rebuild inventories in response to higher demand. Unprecedented inventory reductions of one-half billion dollars were largely responsible for a drop in imports in 1972.

14. Prospects for fixed investment are mixed. Demand for capital equipment and machinery will contribute moderately to import growth in 1973. The gold mining sector is not yet ready to make sizable long-term commitments to develop new mines. In private manufacturing the existence of substantial unused capacity presumably will cause private fixed investments to lag. On the other hand, higher corporate profits and savings since mid-1972 and the recently relaxed credit restrictions are positive factors. Public spending for railroad projects and for expansion of the government-owned steel industry will be increased.

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CONFIDENTIALExports and Capital Inflows Lagging

15. Reduced agricultural exports and a 5% revaluation of the rand in June will slow export growth from 1972's exceptional jump of 43%. Growth in 1973 will approximate the average growth rate of 10% posted since 1965. Drought early in the farming season (October 1972 through May 1973) reduced the corn harvest by 40% compared with 1972. Exports of corn probably will not exceed \$75 million in 1973, compared with more than \$200 million in 1972.

16. Strong foreign demand for other major commodities should largely offset the effect of the drought on exports. Diamond and copper exports, for example, will continue to reflect growth of the US, Japanese, and West European economies. Wool sales should continue at high levels because of heavy demand, especially by Japan, and South Africa's improved competitive position in wool following the approximately 15% devaluation of the rand against the Australian dollar. Exports of sugar and fruit also are expected to rise. Finally, deliveries on large platinum contracts with US automobile manufacturers for new emission control systems may begin by the end of the year.

17. Net capital inflows to South Africa dropped by \$479 million last year and probably will decline further in 1973 (see Table 3). The decline results from UK restrictions imposed in July 1972 on foreign investment by English concerns.

Projected Balance of Payments for 1973

18. Rising import demand set against slower growth in non-gold exports and smaller capital inflows will require Pretoria to finance a substantially larger foreign exchange deficit in 1973, particularly in the final two quarters. The estimates in Table 3 indicate a net foreign exchange deficit, before gold sales, of \$1.7 billion in 1973, compared with \$1.1 billion in 1972.

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CONFIDENTIAL**Table 3****South Africa: Balance-of-Payments Financing Requirements**

	Million US \$ ¹				
	1971	1972	1973		Total ³
			Jan-Jun ²	Jul-Dec ³	
Imports	-4,104	-4,000	-2,350	-2,500	-4,850
Exports	2,184	3,120	1,770	1,700	3,470
Trade balance	-1,920	-880	-580	-800	-1,380
Net services and transfers	-772	-758	-400	-400	-800
Current account	-2,692	-1,638	-980	-1,200	-2,180
Private capital	765	435	210	200	410
Public capital	278	129	15	75	90
Capital account	1,043	564	225	275	500
Financing requirements	-1,649	-1,074	-755	-925	-1,680

1. All data have been derived by converting official rand data into US dollars at the exchange rate fixed in February 1973 - 1 rand equals US \$1.42.

2. Estimated.

3. Projected.

Projected Gold Production and Sales in 1973

19. Because of the exceptionally high price of gold, a moderately reduced volume of gold output in 1973 will be more than adequate to finance the anticipated foreign exchange deficit under current market conditions. Gold production in 1973 will amount to approximately 850 tons, a 7% decline from the 910 tons of 1972. Production at this level would cover the projected financing needs for the balance of payments if prices averaged only about \$60 per ounce throughout 1973.

20. South African gold brought an average price of almost \$85 an ounce in the first half of 1973. Sales of 390 tons yielded \$1,100 million. If the market remains as strong in the second half of the year, Pretoria need sell only an additional 210 tons to bridge the projected exchange gap. With 65% of this year's expected gold revenue needs already met through sales of less than one-half of projected output, South Africa is in an excellent position to withhold gold if the price appears to be weakening.

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21. The free market price of gold is expected to remain high unless marketing from non-South African sources is abruptly increased.* Sizable sales from official gold stocks of countries with large gold reserves would quickly deflate gold prices. The USSR, which runs a distant second to South Africa as a producer of newly mined gold, has had to sell more gold to pay for huge imports of grain. Soviet sales in the first half of 1973 may have reached 150 tons, which would approximately equal sales in all of 1972. Moscow can be counted on to market its gold cautiously because of its vested interest in a high price for gold and its desire to maintain a large emergency gold stock. Notwithstanding the potential for large new marketings, the price of gold will probably remain at a level considerably above the monetary price for several reasons: (a) the strong non-speculative demand for gold, (b) continued speculative demand because of persistent uncertainties about the valuation of major international currencies and the unchecked inflationary tide throughout most of the world, and (c) a reduction in South African sales if prices begin to drop significantly. In any event -- even if the price of gold were depressed to its monetary value -- South Africa's reserves of gold and hard currency will be sufficient to cover the 1973 payments gap.

Beyond 1973

22. Consumer demand, investment, and imports, stimulated by the government's expansionary programs, should grow rapidly in 1974-75. Foreign demand will continue strong for South Africa's non-gold minerals. Demand for exports of agricultural products also will remain strong, but the vagaries of weather will constitute an important vulnerability for these exports. Profitable investment opportunities probably will continue to attract moderate inflows of foreign capital.

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23. Continued high gold prices should string out the decline in gold production at least through 1975. Uncertainty about the stability of gold prices has inhibited investment in new mines and refineries. If work on new mines were begun immediately, the very deep level of gold ores in South Africa -- 2 miles at some sites -- could preclude new production until late in the decade. Current plans call only for the refurbishing and expansion of existing mines. The new physical capacity from this investment will be more than offset by the reduction in the mineral content of the ores mined.

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CONFIDENTIAL**APPENDIX****STATISTICAL TABLES****Table A-1****Official and Free Market Gold Prices**

	<u>US \$ Per Troy Ounce</u>		
	Official Price	Market Price	Market Trend
Through Mar 1968 ¹	35	35	Steady
Apr 1968 - Mar 1969	35	35-44	Up
Apr 1969 ² - Dec 1969 ³	35	44-35	Down
Jan 1970 - Jul 1971	35	35-42	Up
Aug 1971 ⁴ - Dec 1971 ⁵	35	44	Steady
Jan 1972 - Aug 1972 ⁶	38	44-70	Up
Sep 1972 - Jan 1973	38	70-65	Steady
Feb 1973 ⁷ - Jun 1973	42	65-127	Up
Jun 1973 - 20 Jul 1973	42	127-114	Steady

1. Beginning of the two-tier marketing system.

2. Expansion of South African gold sales to amounts exceeding production because of an unfavorable turn in the balance of trade.

3. Signing of the IMF-South African agreement setting a floor price of \$35 per ounce for South African sales.

4. Closing of the US gold window.

5. Signing of the "Smithsonian" agreement, including US and South African currency devaluations.

6. Reduction in May of South African gold sales to less than production because of an increasingly favorable trade balance.

7. Announcement by the United States of a 10% currency devaluation.

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Table A-2
South Africa: Basic Economic Indicators¹

	1965	1966	1967	1968	1969	1970	1971	1972
Gross domestic product (billion current US \$)	11.2	12.1	13.5	14.4	16.1	17.6	19.5	21.9
Gross domestic product (billion 1971 US \$)	14.3	15.0	16.1	16.8	18.0	18.8	19.5	20.2
Population (million persons at mid-year)	17.7	18.3	18.7	19.2	19.6	20.1	21.9	22.6
Per capita GDP (1971 US \$)	810	820	860	880	910	940	890	890
Manufacturing production index (1963-64=100)	116.3	123.7	131.6	137.2	151.3	159.1	162.6	166.9
Corn production (thousand metric tons)	4,279	4,490	5,056	9,762	5,378	6,179	8,600	9,630
Sugar production (thousand metric tons)	1,014	975	1,794	1,823	1,505	1,649	1,399	2,111
Fruit production (thousand metric tons)	775	845	896	869	1,062	1,082	1,210	1,255
Change in commercial and industrial inventories (million US \$)	314	28	670	53	453	643	552	-540
Private fixed investment (million US \$)	1,593	1,666	1,764	1,830	2,069	2,445	2,813	2,790
Private consumption expend- iture (million US \$)	6,897	7,479	8,081	8,857	9,801	10,931	12,079	13,425
Gold production (million troy ounces)	30.5	30.8	30.3	31.1	31.2	32.2	31.4	29.2
Gold sales (million US \$)	1,252	876	1,156	422	1,333	1,643	1,569	1,396
Exports (million US \$)	1,515	1,727	1,879	2,150	2,110	2,046	2,184	3,120
Imports (million US \$)	2,555	2,336	2,758	2,674	3,050	3,669	4,104	4,000
Net capital inflow (million US \$)	362	200	230	648	256	768	1,043	564

1. All value data, except for GDP in constant prices, have been derived by converting official rand data into US dollars at the exchange rate fixed in February 1973 - 1 rand equals US \$1.42.

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CONFIDENTIAL**Table A-3****South Africa: Gold Production**

	Metric Tons
1950	363
1951	358
1952	368
1953	371
1954	412
1955	454
1956	494
1957	530
1958	549
1959	624
1960	665
1961	714
1962	793
1963	853
1964	905
1965	950
1966	960
1967	943
1968	967
1969	970
1970	1,000
1971	976
1972	910
1973	850 ¹
1974	800-850 ²
1975	800-850 ²

1. Estimated on the basis of data for January-May 1973.

2. Estimated.

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